

these issues within the context of this price cap review proceeding. As such, the Commission should institute a separate proceeding on universal service and defer all such issues raised in this price cap review to this separate universal service proceeding.

O. Transition Issue 1: Criteria for Reduced or Streamlined Regulation of Price Cap LECs

Transition Issue 1a:

What is the current state of competition for local exchange and interstate access?

Response:

The extent of competition in local exchange markets varies widely. Rural telephone subscribers continue to rely almost exclusively on LECs for service. Suburban residential subscribers also rely heavily on LECs, but the advent of PCS and the expected provision of telephony services by CATV companies will soon provide these customers with alternative services. Conversely, businesses and interexchange carriers -- particularly those located in larger urban areas -- have the option of using the services of CAPs, where available, or deploying their own private networks using technologies such as VSAT or other means.

Thus, the discussion of the level of competition in LEC markets must recognize the diversity of these markets -- competition may be intense in a downtown Seattle wire center, with services available from a wide variety of providers, with limited competition in a wire center located only 100 miles from

¹³⁸ (...continued)

Also, significant jurisdictional issues arise in any discussion of universal service.

the city center. Any discussion also must recognize that the competitive environment is changing rapidly, with new technologies and service providers entering local exchange markets at an increasing pace. A more comprehensive discussion of local exchange competition is contained in economic studies supporting USTA's filing in this proceeding.¹³⁹

Wireless -- Cellular and PCS

The availability of PCS spectrum will provide an additional alternative to local exchange services. The potential for PCS services to offer a competitive alternative to LECs is evidenced by the Commission's view that there will likely be "60 million PCS users in the U.S. within 10 years."¹⁴⁰ The Commission's view is shared by others. Based on its national survey of telecommunications experts, Mercer Management concluded that wireless service would become a "viable substitute" for traditional wireline services in the next 10 years.¹⁴¹ MCI apparently believes these projections by the Commission and other industry experts are too modest. MCI's Chairman and CEO, Bert

¹³⁹See Harris Study at Appendix B.

¹⁴⁰In the Matter of Amendment of the Commission's Rules to Establish New Personal Communications Services, Notice of Proposed Rulemaking and Tentative Decision, 7 FCC Rcd. 5676, 5688 ¶ 26 (1992).

¹⁴¹Nearly half of the industry experts that Mercer interviewed projected wireless service would become a "viable substitute" for traditional wire-line service within 10 years. . . . Half of those experts interviewed predicted more than 15 percent of the public would be using a wireless handset in five years, compared with the current seven percent. They expect that figure to rise to more than 30 percent in 10 years. The New York Times, Feb. 9, 1994.

Roberts, has cited projections of 80-90 million wireless subscribers by the year 2004.¹⁴² MCI's proposed investments support this view.¹⁴³ MCI has also announced plans to purchase 17 percent of Nextel for \$1.3 billion. Nextel is developing a nation wide digital wireless system, to be offered initially in the nation's top ten markets.¹⁴⁴

The proposed acquisition of McCaw -- the largest cellular provider in the United States -- by AT&T -- the dominant interexchange carrier -- will provide additional opportunities for AT&T to bypass LEC networks.

CATV Companies

Cable companies have extensive local distribution networks that pass most of the homes and businesses within their franchised territory. These networks can be readily adopted to the provision of telephony services. The feasibility of such technology already has been demonstrated in the United Kingdom, where U S WEST and other cable providers are providing telephony service to over 15 percent of all homes passed.¹⁴⁵

¹⁴²"MCI Will Invest \$1.3 Billion in Nextel to Offer Nationally Branded Wireless Services", PR Newswire, Feb. 28, 1994.

¹⁴³MCI has announced its plans to invest \$10 billion to develop an ambitious national PCS network in partnership with more than 250 cable companies, CAPs and independent telephone companies. The PCS network could provide service to 90 percent of the population of the United States. The Wall Street Journal, Feb. 11, 1994, at R22.

¹⁴⁴Dow Jones News Service, Feb. 28, 1994.

¹⁴⁵Harris Study at Appendix B.

Similar plans are underway in the United States. For example:

- **Queens, New York** - Time Warner, MCI and First Pacific are testing voice-over-cable services to 50 households.¹⁴⁶
- **Alexandria, Virginia** - MCI is engaged in a joint trial with Jones Intercable to test the delivery of telephone services over Jones cable TV network.¹⁴⁷
- **Orlando, Florida** - U S WEST and Time Warner are engaged in a joint arrangement to offer the Full Service Network -- delivering both cable TV and telephony over a single facility.
- **Long Island, New York** - CableVision and AT&T will provide local telephone and cable TV service to the C.W. Post University Campus, bypassing NYNEX for all but local calls placed to off-campus locations. CableVision has also announced plans to offer alternative telephone service to its cable subscribers on Long Island and New York.¹⁴⁸

Competitive Access Providers

CAPs have tended to locate their services in urban centers. This is not surprising, since that is where the bulk of the LEC traffic is located. This is particularly true in the U S WEST

¹⁴⁶Communications Daily, Jan. 10, 1994.

¹⁴⁷MCI's planned test of the delivery of interexchange telephone services over Jones Intercable Inc.'s cable TV system in Alexandria, Virginia, will begin in "late April or early May," a spokesman said last week. A separate technical and market trial of providing local and interexchange services over a Jones Intercable system in the Chicago area will begin in the fourth quarter, the spokesman told Telecommunications Reports.

Asked to comment on press reports that MCI is negotiating with cable TV operators to provide local access services in competition with incumbent telephone companies, the spokesman said, MCI is "just looking to cable as a possible local access alternative". See Telecommunications Reports, Apr. 18, 1994, at 4.

¹⁴⁸News Day, Feb. 25, 1993.

region. Most of the population of the region is located in highly concentrated urban centers with the remainder of the population located in areas of extremely low population density.¹⁴⁹ The high concentration of population in urban centers makes U S WEST particularly attractive to CAPs. For example, in the State of Washington, 30 percent of U S WEST's business calling revenues are derived from only 0.1 percent of the land area.

<u>Land Area</u>	<u>Business Calling Revenues</u>
<0.1%	30%
<1.0%	52%
<2.0%	76%
<5.0%	88%

This high concentration of traffic in a relatively small portion of U S WEST's territory means a competitor can enter the market with a network that provides a small fraction of the coverage of U S WEST's network -- yet still have access to a large percentage of the U S WEST business customer's traffic. For example, 42 percent of U S WEST's interstate access revenues are provided by customers in just five Metropolitan Statistical Areas -- Denver, Minneapolis-St. Paul, Phoenix, Portland and Seattle.¹⁵⁰ And, 63 percent of U S WEST's interstate access revenues are located in just 15 Metropolitan Statistical Areas.¹⁵¹ Thus, it is not surprising that there are as many as

¹⁴⁹The uniqueness of the U S WEST region in this regard is illustrated in Attachment 7.

¹⁵⁰See Attachment 8.

¹⁵¹Id.

22 CAPs in operation or in the planning stages in the U S WEST region. These CAPs are located in 11 of U S WEST's largest cities.¹⁵² Many of these CAPs have substantial resources. For example, MFS is a publicly traded company with a market value of nearly \$2 billion.¹⁵³

CAPs typically provide DS1 and DS3 services -- services that compete directly with U S WEST's DS1 and DS3 services -- to business customers. Also, CAP DS1 and DS3 services are used in place of U S WEST's switched access services -- thereby allowing customers to bypass U S WEST's switched network for connections to IXCs.

CAP services will not be limited to DS1 and DS3 services in the future. For example, on January 27, 1994, Electric Lightwave filed an application with the Washington Utilities and Transportation Commission¹⁵⁴ for certification to provide intrastate, intraexchange switched telecommunications services.¹⁵⁵ On March 17, 1994, the Supreme Court of the State

¹⁵²A listing of the CAPs located in the U S WEST region is included in Attachment 9.

¹⁵³Business Week, March 28, 1994, at 69.

¹⁵⁴Petition of Electric Lightwave for an Order Granting Amendment to Registration Application, filed Jan. 27, 1994.

¹⁵⁵Electric Lightwave already has permission from regulators to offer private line service, including data and video transmission, over its growing fiber optic network, as long as phone calls are routed through U S WEST.

But now the company is proposing to handle its own switching -- in effect, establishing a separate phone company alongside U S WEST.

(continued...)

of Washington affirmed a lower court's decision that the Washington Utilities and Transportation Commission does not have the authority to grant exclusive rights to telecommunications companies.¹⁵⁶ As a result of that finding, on April 21, 1994, Digital Direct of Seattle, Inc. ("DDS"), filed an application with the State of Washington Utilities and Transportation Commission for certification to provide local exchange services in competition with U S WEST. In that certification request, DDS provided the following description of the services it intends to offer:

DDS will provide switched services for transmission of information in a variety of speeds and formats depending upon customer requirements. Transport will be provided over fiber optic facilities that are owned by DDS or are obtained from others. Switching will be provided using a digital switch to be installed by DDS.

DDS intends to offer interchange services, primarily consisting of intraLATA toll services and switched access services. DDS will offer interexchange switched services between customers, for both voice and data. Additionally, DDS will offer shared digital switching services, comparable to LEC Centrex services, and payphone services. . . .

¹⁵⁵(...continued)

Earl Kansky, Electric Lightwave's vice president, said his company intends initially to offer local exchange service targeted to business. Residential service will be offered later, although company officials said that could take years. The company has also asked to offer instate long-distance services.

Jim Erickson, "An Effort to Take on U S WEST -- Network seeks to offer local dialing in Seattle," Seattle Times, Feb. 11, 1994, at B6, B10.

¹⁵⁶The Court's holding "forbid[s] the Commission from legally conferring on any LEC the right to be the exclusive provider of telecommunications services in a given exchange." In Re Electric Lightwave, Inc. 869 P.2d 1045, 1052 ¶ 10 (Wash. 1994).

DDS will offer services throughout the State of Washington, where customer demand requires and network facilities permit.¹⁵⁷

Teleport has also filed for authorization to acquire DDS.¹⁵⁸ Electric Lightwave and DDS/Teleport's plans for competitive local exchange services are not unique to Seattle. For example, U S WEST has received requests for the assignment of central office codes by CAPs located in Seattle, Portland, Denver, and Vancouver. All of these requests have been granted.

Another major telecommunications provider -- MCI -- has announced plans to provide competitive local access services in several major metropolitan areas throughout the United States.¹⁵⁹ MCI has also announced an alliance with Hancock

¹⁵⁷Petition of Digital Direct of Seattle, Inc., to amend registration to offer switched telecommunications services, filed Apr. 21, 1994, at Exhibit A.

¹⁵⁸Application of TCG Seattle for authority to acquire Digital Direct of Seattle, Inc., and to provide telecommunications services, filed Apr. 21, 1994, with the Washington Utilities and Transportation Commission. TCG of Seattle is a partnership of some of the major cable companies in the United States, including Viacom, Cox, TCI, Comcast and Continental.

¹⁵⁹Initially, MCI intends to use the fibers to link its corporate customers directly to its long-distance network, bypassing the local Bell Telephone Companies -- and avoiding the "access" charges MCI now pays the phone companies for local connections to corporate customers . . . MCI officials said today that the first wave of new networks would be built in Atlanta, New York, Chicago, Los Angeles and more than a dozen other big cities. While the plan seems skeletal at first glance, MCI officials said these networks would run through high traffic corporate corridors that now account for 40 percent of all its long-distance traffic. Bert Roberts, MCI's Chairman and CEO said, "By now it is clear that the local telephone monopolies will never give us what we need, contending they had not provided 'local access capabilities at a decent
(continued...)

Telephone Company to offer local exchange services in direct competition with Ameritech in Indianapolis.¹⁶⁰

In summary, competitive alternatives for LEC access services either exist or will exist in the near future in virtually all cities of any significant size. Though U S WEST serves a huge service area, it is no different from any other LEC in that the vast majority of its business is concentrated in a few large cities. As such, it is imperative that the Commission adapt a LEC price cap plan that accommodates competition.

Transition Issue 1b:

What criteria if any should be used for determining when reduced or streamlined regulation for price cap LECs should take effect?

Response:

U S WEST believes it is essential that the Commission establish a mechanism that can adapt the level of regulation in a market to the level of competition. The adoption of such a mechanism should not be delayed -- many of U S WEST's wire centers already are served by competitors. As we demonstrate in the response to Transition Issue 1a above, the level of competition can be expected to increase dramatically, especially in our larger cities.

¹⁵⁹(...continued)
price.'"

"MCI Plans to Enter Local Markets," The New York Times, Jan. 5, 1994.

¹⁶⁰MCI Press Release, Mar. 19, 1994.

In its comments in this proceeding, USTA proposes a mechanism under which a LEC could demonstrate that a wire center qualifies for treatment as a CAP. That mechanism is based on the notion of addressability -- which essentially measures the extent to which customers have alternative sources of supply.¹⁶¹ USTA also proposes the Commission require interstate common carriers to include service area descriptions as a part of their interstate tariffs. The availability of service area descriptions will, for the first time, permit the Commission to assess effectively the extent of competition in a local exchange market.

U S WEST supports USTA's Proposal for a trigger mechanism incorporating the concept of addressability as a surrogate measure of market power, as well as its proposal to require interstate common carriers to provide service area descriptions in their tariffs. U S WEST believes the USTA proposal represents a conservative approach to measuring market power and is consistent with a wide range of legal precedents. Attachment 1 contains a detailed legal analysis of the overall market power issue, including an examination of antitrust principles and a review of relevant legal precedents.¹⁶² Attachment 1 also specifically evaluates the USTA Proposal in the context of modern antitrust analysis.¹⁶³

¹⁶¹See Competitive Market Area Demonstration and Data Reporting Requirements, a USTA Position Paper.

¹⁶²See Attachment 1, Market Power: An Antitrust Application for the LEC Price Cap Review, Sharon L. Naylor, Senior Attorney, U S WEST, Inc.

¹⁶³Id. at 25-28.

A. Market Power

The Commission has stated that market power is "the ability to restrict output or raise price over what would prevail in a competitive market, and maintain it over time."¹⁶⁴ Current regulations are based on the assumption that local exchange carriers retain substantial market power in all their markets. These regulations are intended to serve as a substitute for market forces. However, once a LEC has lost market power -- due to the presence of competitive forces -- the need for regulation no longer exists. Any trigger mechanism that is designed to streamline regulation in competitive markets must therefore include a measure of the incumbent's market power. Essentially, such a mechanism asks the question: do customers have alternative sources of supply?

A critical first inquiry in evaluating market power, of course, is to define the relevant market. Attachment 1 presents an antitrust treatment for market definition and suggests appropriate market parameters for the Commission's prospective purposes in addressing these transition issues.¹⁶⁵ More specifically to the present situation, as USTA's approach makes clear, the question of market power for access services can be answered only for a relatively small geographic area. The availability of an alternative supplier in Seattle does the customer in Walla Walla little good. Moreover, any market

¹⁶⁴In the Matter of Competition, Rate Deregulation and the Commission's Policies Relating to the Provision of Cable Television Service, Report, 5 FCC Rcd. 4962, 4968 n.19 (1990).

¹⁶⁵Attachment 1 at 14-25.

measure aggregated at a national level would be misleading by rolling up some local markets which are more competitive with others that are less competitive. By doing so, it would obscure the very differences between these markets that the Commission seeks to reveal through its trigger mechanism.

B. Indicators of Market Power

Several possible indicators have been suggested by various parties as measures of LEC market power for access services -- market share, capacity, contestability and addressability. The following is a brief discussion of each of these concepts.

1. Market Share

Some parties have proposed that the Commission delay streamlining regulation until competitors have attained some threshold level of market share.¹⁶⁶ It is claimed that only in this way can the Commission ensure that "effective competition" has arrived before it loosens the constraints on the incumbent. However, the weakness of market share as a measure of market power has been recognized by the Courts:

[R]eliance on market share statistics is likely to be an inaccurate or misleading indicator of "monopoly power" in a regulated setting. . . . Indeed, while a regulated firm's dominant share of the market typically explains why it is subject to regulation, the firm's statistical dominance may also be the result of regulation. . . . Ultimately, [the] analysis must

¹⁶⁶See, e.g., The Unlevel Playing Field: Asymmetric Market Power Demands Asymmetric Regulation, Teleport Communication Group, March 1994, at 12.

focus directly on the ability of the regulated company to control prices or exclude competition. . .¹⁶⁷

The use of market share is particularly inappropriate in the case of local exchange markets, which are rapidly transitioning from a regulated monopoly to a highly competitive market. Because market share is inherently a backward-looking measure, it cannot assess the extent to which customers today are considering alternative suppliers, and thus, the extent to which an incumbent firms market power has been eroded by competitive entry.

2. Capacity

In its evaluation of AT&T's market power, the Commission relied heavily on measures of the capacity of AT&T's interexchange competitors.¹⁶⁸ For customers to be able to exercise their competitive choices, alternative providers must have sufficient capacity to satisfy their demand. To thwart the potential exercise of market power, alternate providers must have sufficient capacity to make anti-competitive price increase unprofitable.¹⁶⁹ The ability of competitors to supply is also recognized in the Justice Department/Federal Trade Commission's merger guidelines. For markets where relatively undifferentiated, homogenous products are involved, such as

¹⁶⁷MCI Communications Corp. v. AT&T, 708 F.2d 1081, 1107 (7th Cir.), cert. denied, 464 US 891 (1983). See also Attachment 1 at 2-8.

¹⁶⁸See In the Matter of Competition in the Interstate Interexchange Marketplace, Report and Order, 6 FCC Rcd. 5880, 5888-89 ¶ 46 (1991).

¹⁶⁹See Attachment 1 at 5-6.

access, the guidelines call for "physical capacity or reserves" to be used as a measure of market share.¹⁷⁰

While latent capacity is an important indicator of the ability to exercise market power, it may not be feasible for the Commission to examine alternative providers' capacity on a case-by-case basis as part of a trigger mechanism.

3. Contestability

If there are no significant barriers to entry, the expectation of market entry will affect the behavior of the incumbent. When considering a price increase, the incumbent will consider the possibility that the increase will stimulate entry, and that the presence of the entrants will then make the increase unsustainable.¹⁷¹ Given these conditions, market discipline will be exerted on the incumbent, even if competitors have not yet constructed facilities. Such a market is said to be contestable. A criterion based on satisfying the conditions for contestability may be appropriate in some circumstances. However, the actual contestability of a particular market may be difficult to quantify.

¹⁷⁰U.S. Department of Justice, Merger Guidelines § 1.41, 4 Trade Reg. Rep. (CCH) ¶ 13,104 (May 5, 1994). See also 1984 DOJ Merger Guidelines § 2.4, Trade Reg. Rep. ¶ 13,301 (1988). See Attachment 1 at 6 n.4.

¹⁷¹See William J. Baumol, John C. Panzar and Robert D. Willig, Contestable Markets and the Theory of Industry Structure, at 349-50 (1982).

4. Addressability

For a customer's demand to be addressable, an alternative provider must already have facilities near enough to the customers' location so that the provider can readily extend service to that customer upon request. Unlike market share, addressability is a forward looking indicator. It asks whether customers have choices, rather than recording choices customers have made in the past. As part of a trigger mechanism, it therefore allows the Commission to adjust its regulation once the LEC has lost market power, but before entrants have made all their investment decisions, and before customers have made their purchase decisions. Such a framework is more likely to promote effective competition, and less likely to predetermine the outcome, than a reliance on market share.¹⁷²

Unlike contestability, addressability is based on the physical presence of alternative providers with the capacity and geographic coverage to serve a substantial portion of the market. It therefore allows the Commission to base its decisions on observed fact, rather than prediction. It does not rely on the expectation of future entry, or the geographic extension of existing networks, even though both events are likely, and the anticipation of these events would affect the behavior of the incumbent LEC.

¹⁷²See Attachment 1 at 7 n.8 and accompanying text regarding the false economic signals entrants would receive if the Commission retains regulatory restrictions beyond their useful life.

Addressability incorporates traditional indicators of capacity, but adds a measure of the alternative providers' ability to deliver services to the locations where customers want them. This feature makes addressability particularly suitable as an indicator of market power in access markets, where demand, and the facilities needed to serve it, is more specific to particular locations than is the case in interexchange markets.

C. Measurement of Addressability will Require the Filing of Service area Descriptions by Competitive Access Providers

When LECs supplied virtually all of the access demand, their records could provide a complete picture of the market. Today, this is no longer the case. In many areas, major customers have already shifted a significant portion of their demand to a variety of alternative providers. LEC records cannot document the availability of these alternatives, nor does the Commission have any mechanism in place to observe them. As competition develops, the shortfall in the information available to the Commission will become more severe.

To obtain consistent, reliable information about the state of competition in access markets, the Commission should require reporting from all market participants. To establish parity of regulatory treatment, these reporting requirements should be equivalent for all participants. Finally, the information requested should be designed to provide input to the indicator(s) of market power that the Commission chooses as the driver for its trigger mechanism.

In its comments in this proceeding, USTA proposes that the Commission require interstate common carriers to provide a description of the service area in which they stand ready to make their services generally available to all customers. Service area descriptions would be included as a part of their interstate tariffs. Such a requirement could be satisfied by a general description of the service area (e.g., a listing of zip codes, city or county boundaries, LEC wire centers, etc.), or through the filing of a service area map. These service area descriptions will provide the Commission with a very clear picture of the extent to which customers in a particular geographic area have access to alternative providers, and for which services.

To the extent that the Commission does not require interstate common carriers to file service area descriptions or maps with their tariffs, or does not require these carriers to make their services available to all customers within their service areas, U S WEST agrees with USTA that the Commission should require such carriers to file facility maps with the Commission on an annual basis. Such facility maps would describe the route of the backbone network facility within each geographic area served by the common carrier -- on both a current basis, as well as planned additions within the next year.

Transition Issue 1c:

In what circumstances will a LEC no longer control essential "bottleneck" facilities for some or all of its services? How will the Commission be able to identify these circumstances in practice?

Response:

As stated, Transition Issue 1c assumes that U S WEST and other LECs currently control "essential facilities." While this assumption may have been valid in the past, it is of questionable validity today. As U S WEST points out in Attachment 2, the essential facilities antitrust doctrine is an exception to the general rule that a firm may decide unilaterally whether to make a particular asset, or scarce resource, available to competitors.¹⁷³ Rather than placing the burden of proof on LECs to show the facilities are not essential, the law requires just the opposite. That is, parties asserting that a particular facility is essential have the burden of proof. U S WEST questions whether any competitor could meet this burden of proof in today's telecommunications environment. As discussed in Attachment 2, to show that a LEC facility is essential, a competitor would have to show that:

- a facility is vital to competitive survival;
- no alternatives to the facility currently exist;
- a facility cannot practically or reasonably be duplicated;
- LEC control of the facility must allow it to eliminate, not merely impede, competition; and
- LEC access to or use of the facility would not be impaired by a competitor's use of the facility.

¹⁷³See Attachment 2 for a detailed discussion of the essential facilities doctrine and the current state of the law surrounding it. A close reading of Attachment 2 demonstrates that the essential facilities doctrine is much narrower than many LEC adversaries contend.

Clearly, few, if any, LEC facilities would be found to be essential facilities if the above standards were applied.

Transition Issue 1d:

What ability do CAPs and others have to compete with the LECs? What data indicate the level of actual and potential competition from CAPs and other providers? For example, such data may include the CAPs' profit levels, stock price trends, revenues, or other measures which reflect the CAPs' ability to compete.

Response:

See Response to Transition Issue 1b above.

Transition Issue 1e:

What impact should price cap LEC entry into related industries (e.g., cable TV) and BOC entry into inter-LATA marketplaces have on the LEC price cap plan?

Response:

LEC entry into related industries/markets -- whether they be regulated or unregulated -- should have no impact on the LEC price cap plan. As Attachment 3 demonstrates, LECs cannot improperly leverage their existing market positions to advantage themselves in adjacent markets. Even if it is assumed that LECs have a monopoly in some of the markets they currently serve, this does not imply that LECs should be limited or precluded from serving other markets. Furthermore, no purpose would be served in shifting costs from unregulated operations to regulated operations since regulated prices cannot be increased with price cap regulation. Absent evidence that LECs can leverage their

market positions into adjacent, otherwise competitive markets, the Commission should treat LECs no differently than other contenders in those markets.

P. Transition Issue 2:

What regulatory methods for reducing price cap regulation or streamlined regulation should be adopted for LEC services as those services become subject to greater competition?

Response:

As discussed above, the USTA Proposal reduces the scope of price cap regulation and allows for streamlined regulation as LEC competition increases. If the Commission adopts the USTA Proposal, it will have a mechanism in place to accommodate competition as it arises without regulatory delay.

Q. Transition Issue 3:

Whether and how the Commission should schedule revisions in the composition of price cap baskets as local exchange access competition develops. Should the Commission adopt a set of procedures that would rebalance baskets in response to specified changes in market conditions?

Response:

As discussed in Section III(D) above, the Commission should revise the composition of the price cap baskets to become effective January 1, 1995. The composition of these baskets should be allowed to change as more and more LEC wire centers are identified as CMAs in accordance with USTA's access reform proposal. As CMAs are identified, the services in these areas

would automatically be removed from price cap baskets and price cap regulation. If any further modifications appear to be necessary they should be addressed in the next price cap review. The Commission should make every attempt to avoid conducting any "interim" proceedings between price cap reviews -- whether it be to address the composition of price cap baskets or any other equally important issue. Price cap regulation will never achieve its potential if the price cap plan is continually being fine-tuned. Stability is essential if efficiency incentives are to be preserved in price cap regulation. As such, the Commission should make all necessary revisions to price cap baskets (and service categories and bands) and establish any thresholds/triggers in this proceeding and allow the plan to remain unchanged until the next review.

R. Transition Issue 4:

Whether and how the Commission should revise its monitoring of LEC service quality, network reliability, and infrastructure as part of any transition plan.

Response:

See supra Section III (I)

S. Transition Issue 5:

When should the Commission next review price cap LECs' performance? How frequently should the Commission conduct subsequent reviews?

Response:¹⁷⁴

The length of time between price cap reviews is a critical factor in determining LEC incentives and potential efficiency gains under a price cap plan. This assumes, of course, that the price cap plan is stable -- remains unchanged -- between reviews. SPR and others found that efficiency incentives rise significantly as the length of term or review period is increased.¹⁷⁵ However, the longer the time between review periods, the greater the risk of uncertainty. The Commission should balance this risk against potential efficiency gains in selecting the date of the next price cap review. SPR, citing Schmalensee's research, suggests that the period between reviews should be 8-10 years for a pure price cap plan.¹⁷⁶

U S WEST believes that if the Commission adopts a price cap plan that accommodates competition, eliminates sharing and streamlines the introduction of new services, the plan should remain in place for six years with a review beginning at the end of the fifth year.¹⁷⁷ This is a long enough period of time to ensure that the plan includes sufficient efficiency incentives

¹⁷⁴See supra pp. 20-21.

¹⁷⁵SPR Study at 16-24; Paul R. Joskow and Richard Schmalensee, Incentive Regulation for Electric Utilities, Yale J. on Reg., Fall 1986, at 25.

¹⁷⁶SPR at 20.

¹⁷⁷If the Commission adopts a six-year plan, it can determine the frequency and need for subsequent reviews in the next review. It is quite possible that only a minimal amount of LEC regulation will be necessary if telecommunications markets continue to experience the same amount of change that they have in recent years.

but not so long as to incur inordinate risk in a rapidly changing environment. While there may have been good reasons to employ a shorter period (i.e., four years) at the commencement of price cap regulation, this justification no longer exists after three full years of experience.

T. Transition Issue 6:

Whether and how the Commission should adopt changes in rules and policies other than those specifically mentioned in this Notice as part of a LEC price cap transition plan.

Response:

Rather than expanding the price cap review further, either for the purposes of addressing general, baseline or transition issues, U S WEST believes this proceeding should be much narrower than the scope of the Commission's NPRM. This price cap review cannot and should not be used to try to solve every problem facing the telecommunications industry today or as a vehicle to advance any particular social agenda -- regardless of its importance. The Commission should take great care to avoid taking any actions which might jeopardize the efficiency gains and incentives which are contained in the current price cap plan. The benefits of price cap regulation will be lost if the Commission attempts to modify the LEC price cap plan to address every issued raised in the NPRM.

The Commission should limit this proceeding to achieving the following objectives:

- removing the last remnants of rate of return regulation from the price cap plan;
- modifying the price cap plan to accommodate competition in those areas where it exists or is evolving; and
- streamlining the rules for introducing new services.

By doing so, the Commission can serve the public interest by increasing the efficiency incentives of the current plan.

IV. CONCLUSION

U S WEST urges the Commission to modify the LEC price cap plan as discussed in the above comments.

Respectfully submitted,

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Attachment 1